SOUTH AFRICAN REVENUE SERVICE

INTERPRETATION NOTE: NO. 9 (ISSUE 4)

DATE: 19 February 2007

ACT : INCOME TAX ACT, No. 58 of 1962 (the Act)
SECTION : SECTION 12E
SUBJECT : SMALL BUSINESS CORPORATIONS

Archived

1. Purpose

The purpose of this Note is to provide guidance as to the application of the provisions of section 12E of the Act with reference to the requirements that have to be met in order to qualify as a Small Business Corporation (SBC). Due to various amendments since the introduction of the section 12E it will be necessary to consult previous issues in respect of the rates and requirements applicable to a specific year of assessment. Previous issues of this Note can be accessed from the archive folder. This Note takes into account the changes effected by sections 24 and 62(2) of the Small Business Tax Amnesty and Amendment of Taxation Laws Act No. 9 of 2006 and sections 3, 14 and 39 of the Revenue Laws Amendment Act No. 20 of 2006.

2. Background

Section 12E of the Act provides for a special dispensation applicable to SBCs. The benefits that emanate from qualifying as an SBC are as follows:

a) An SBC which carries on a process of manufacture (or any other process which in the opinion of the Commissioner for the SARS is of a similar nature) may write off expenditure incurred on or after 1 April 2001 in respect of the acquisition of plant or machinery ("assets") in full in the year in which the assets are brought into use for the first time by the taxpayer in a manufacturing or similar process.

b) An accelerated allowance for machinery, plant, implement, utensil, article, aircraft or ship (other than plant or machinery used in a manufacturing or similar process) acquired on or after 1 April 2005, at 50% of the cost of that asset in the first year of assessment during which that asset is or was brought into use for the first time, 30% in the second year and 20% in the third year.

c) The rate of tax on the taxable income of an SBC is considerably lower than the normal rate of tax for companies in general. A company pays tax at the rate of 29% on its taxable income, whilst an SBC will pay 0% tax on the first R40 000 of taxable income, 10% of the amount by which taxable income exceeds R40 000

and 29% of the amount by which taxable income exceeds R300 000. This tax rate structure is applicable for the years of assessment ending between 1 April 2006 and 31 March 2007.

3. The law and its application

The three main definitions are:

An SBC is defined in section 12E(4) to mean the following:

'**small business corporation**' means any close corporation, co-operative or company registered as a private company in terms of the Companies Act, 1973 (Act No. 61 of 1973), all the shareholders of which are at all times during the year of assessment natural persons, where —

(i) the gross income for the year of assessment does not exceed R14 million: Provided that where the close corporation or company during the relevant year of assessment carries on any trade, for purposes of which any asset contemplated in this section is used, for a period which is less than 12 months, the amount of R14 million shall be reduced to an amount which bears to R14 million, the same ratio as the number of months (in the determination of which a part of a month shall be reckoned as a full month). during which that company or close corporation carried on that trade bears to 12 months;

(ii) none of the shareholders or members at any time during the year of assessment of the company or close corporation holds any shares or has any interest in the equity of any other company as defined in section 1, other than–

(aa) a company contemplated in paragraph (a) of the definition of 'listed company';

(bb) any portfolio in a collective investment scheme contemplated in paragraph (e) of the definition of 'company'; or

(cc) a company contemplated in section 10(1)(e)(i), (ii) or (iii);

(dd) a social or consumer co-operative or a co-operative burial society as defined in section 1 of the Co-operative Act, 2005 (Act No. 14 of 2005) or any other similar co-operative if all of the income derived from the trade of that co-operative during any year of assessment is solely derived from its members; or

(ee) any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956);

(iii) not more than 20 per cent of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains of the company or close corporation consists collectively of investment income and income from the rendering of a personal service; and

(iv) such company is not an employment company;"

Archived

'**employment income**' means any company –

(i) which is a labour broker as defined in the Fourth Schedule to the Act, other than labour broker in respect of which a certificate of exemption has been issued in terms of paragraph 2(5) of the said Schedule; or

(ii) which is a personal service company as defined in the Fourth schedule;

'**investment Income**' means –

(i) any income in the form of dividends, royalties, rental derived in respect of immovable property, annuities or income of a similar nature; and

(ii) any interest as contemplated in section 24J, any amount contemplated in section 24K and any other income which, by laws of the Republic administered by the Commissioner, is subject to the same treatment as income from money lent; and

(iii) any proceeds derived from investment of trading in financial instruments (including futures, options and other derivatives), marketable securities or immovable property;

Archived

Inherently the definitions focus on the various requirements that have to be met in order to qualify as an SBC as well as some exclusion from the definition. The various specific requirements are:

a) A company, co-operative or close corporation

An SBC is limited to a private company registered in terms of the Companies Act, 1973 (Act No 61 of 1973), a co-operative as defined in section 1 of the Co-operatives Act, 2005 (Act No. 14 of 2005) or a close corporation registered in terms of the Close Corporation Act, 1984 (Act No. 69 of 1984). A company registered in terms of foreign legislation will therefore not qualify.

Any reference to a 'company' and 'shareholder' in this Note includes a 'close corporation' and a 'co-operative' and a 'member' of a close corporation and a co-operative respectively.

The definition of an SBC was amended by section 14(a) of the Revenue Laws Amendment Act No. 20 of 2006 to include co-operatives, with effect from the commencement of years of assessment ending on or after 1 January 2007.

b) Shareholding

All the shareholding or members' interest of an SBC must at all times during the relevant year of assessment be held by natural persons (section 12E(4)(a)).

Section 12E(4)(a)(ii) provides that "none of the shareholders or members at any time during the year of assessment of the company or close corporation holds any shares or has any interest in the equity of any other company …". A share or interest held in another company or close corporation as trustee or as nominee will generally not be regarded as the holding of any shares or interest in the equity of any other company for purposes of this section, provided the shareholder/member will not be entitled to any profits, income or capital in the other company or close corporation.

c) Gross income limitation

In order to qualify as an SBC, a company's gross income may not be in excess of R14 million during the year of assessment (previously R6 million). The R14 million is applicable from the commencement of years of assessment ending on or after 1 January 2007 (see sections 24 and 62(2) of Act No. 9 of 2006). Gross income (as defined in section 1 of the Act) refers to all receipts/accruals excluding receipts/accruals of a capital nature. Gross income includes exempt income (such as dividends from a South African source), but excludes a capital gain.

The limitation on the gross income refers to the gross income received or accrued for a full period of 12 months, i.e. a full year of assessment. Where the company commenced or ceased trading during the year the R14 million must be reduced proportionately in order to determine whether the gross income received or accrued for the relevant period in question would have exceeded R14 million.

Note: A person will be taxed on an amount as defined in the definition of "gross income" either on receipt or accrual of such amount, whichever occurs first.

Archived

Example 1

A company with a financial year-end of 30 June commences trading activities on 17 December 2005. The gross income for the six-month period 1 December 2005 to 30 June 2006 amounts to R7.5 million.

As the company's financial year ends before 1 January 2007, the limitation of R6 million is applicable in this instance. This gross income must be reduced proportionately in order to determine what the company's gross income limit for the six-month period should be:

	R6 million	x	$\frac{\text{months actually traded}}{\text{12 months}}$
=	R6 million	x	$\frac{\text{7 months}}{\text{12 months}}$
=	R3.5 million		

The gross income of the company may therefore not exceed an amount of R3.5 million

for the seven months in which it traded. Its gross income for the period, however, amounts to R7.5 million and notwithstanding the fact that it may have complied with all the other requirements of an SBC, the non-compliance with the gross income requirement disqualifies the company for the SBC relief for the relevant year of assessment.

Note: In terms of section 12E(4)(a)(i), a part of a month is reckoned as a full month. The full month of December is therefore taken into account.

d) Limitations on shareholders

Over and above the requirement that all the shareholders or members must be natural persons, the shareholders/members may not at any time during the year of assessment hold any shares or have any interest in the equity of any other company, except for those specifically excluded. Any shares or any interest in such other company, albeit for one day during the year of assessment will disqualify a company notwithstanding the fact that all the other requirements have been met. The reference to 'any other company' includes a co-operative, close corporation, a dormant or shelf company.

Excluded from the above limitation are shares or interests held in -

i) a company contemplated in paragraph (a) of the definition of 'listed company', i.e. a company of which the shares or depository receipts in respect of its shares are listed on an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, No. 36 of 2004 [section 12E(4)(a)(ii)(aa)];

ii) any portfolio in a collective investment scheme contemplated in paragraph (e) of the definition of 'company', i.e. any portfolio comprised in any collective investment scheme in securities as contemplated in Part IV of the Collective Investment Schemes Control Act, No. 45 of 2002 or any arrangement or scheme carried on outside the Republic where investors hold a participatory interest through shares, units or any other form of participatory interest [section 12E(4)(a)(ii)(bb)]; or

iii) a company contemplated in section 10(1)(e)(i), (ii) or (iii) [section 12E(4)(a)(ii)(cc)], that is -

- a body corporate established in terms of the Sectional Titles Act, No. 95 of 1986;
- a share block company established in terms of the Share Block Control Act, No. 59 of 1980; or

Archived

- any other association of persons (excluding companies, co-operatives, close corporations and trusts, but including a company incorporated under section 21 of the Companies Act, 1973).

iv) Certain co-operatives, as defined in section 1 of the Co-operatives Act, 2005 (Act No. 14 of 2005), if all the income derived from the trade of the co-operative during the year of assessment is solely derived from its members. The specified co-operatives must be registered as one of the following:

- A social co-operative, i.e. a non-profit co-operative which engages in the provision of social services to its members, such as care for the elderly, children and the sick (for example, as child nursery facilities).

- A consumer co-operative, i.e. a co-operative that procures and distributes goods or commodities to its members and non-members and provides services to its members (such as consumer buy-aids).

- A co-operative burial society, i.e. a co-operative that provides funeral benefits, including funeral insurance and other services to its members and their dependants.

Membership of the following co-operatives (as defined in the Co-operatives Act) will continue to exclude an SBC from qualifying:

- Housing co-operatives
- Worker co-operates
- Agricultural co-operatives
- Financial services co-operatives
- Marketing and supply co-operatives
- Service co-operatives

v) Any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956). A friendly society is a form of organisation established for the mutual assistance of its members, and it must be registered as such in terms of the Friendly Societies Act.

Example 2

Company A, which renders information technology (IT) services to a number of clients, has two shareholders as well as four other employees, who throughout the year of assessment were involved in rendering the IT services. Company A's gross income for the year of assessment was R5,6 million. Shareholder No. 1 is

Archived

the holder of a number of shares (allocated to an apartment purchased by him) in a share block company. Shareholder No. 2 is the holder of shares in company Z, which were listed on the JSE. Company Z's shares were delisted during the course of the financial year. Company A complied with the following requirements:

1. The shares in company A are all held by natural persons
2. The gross income does not exceed R14 million
3. Although company A renders a 'personal service' as defined, it employs three or more full time employees (excluding the shareholders) who, throughout the year of assessment, also render IT services
4. The shares held, in the share block company, by shareholder No. 1 are permitted in terms of section 12E(4)(a)(ii)(cc)

Company A is however disqualified and cannot be regarded as an SBC for the following reason:

Section 12E(4)(a)(ii) indicates that a shareholder/member may not hold any shares or have any interest in any company other than a company contemplated in paragraph (a) of the definition of "listed company". Shares held in any other company (i.e. a company whose shares or depository receipts in respect of its shares are not listed on an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004) are prohibited. The shares held by shareholder No. 2 in the delisted company, disqualifies company A. Company A will, as a result, not be regarded as an SBC for the specific year of assessment.

Archived

e) Limitation on investment income and income from rendering a personal service

A maximum of 20% of the company's total receipts and accruals, including capital gains but excluding amounts of a capital nature, may consist collectively of 'investment income' as defined in section 12E(4)(c) and income from the rendering of a 'personal service' as defined in section 12E(4)(d). The aggregate income from investment and personal services should, therefore, not exceed 20% of the company's total receipts and accruals. Where a company, for example, has no investment income, the personal service income may not exceed 20% of the receipts and accruals. Where the service rendered by a company is not regarded as personal service, the investment income may not exceed 20% of the company's total receipts and accruals. However, where the service rendered is regarded as personal service, the 20% limitation must be applied to the income attributable to the personal service and the investment income collectively.

Investment income

Investment income includes income derived from dividends, royalties, rental derived in respect of immovable property, annuities or income of a similar nature, interest as contemplated in section 24J of the Act, any amount contemplated in section 24K of the Act as and any other income subject to the same treatment as income from money lent.

The investment income listed in section 12E refers mainly to amounts, which represent the return on investments. Any proceeds derived from investment or trading in financial instruments, marketable securities or immovable property are for the purposes of section 12E also regarded as investment income.

Personal service

The term "personal service" is defined in section 12E(4)(d) as follows:

> '**personal service**' , in relation to a company or close corporation, means any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsmanship, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate, research, secretarial services, sport, surveying, translation, valuation or veterinary science, if -
>
> (i) that service is performed personally by any person who holds an interest in that company or close corporation; and
>
> (ii) that company or close corporation does not throughout the year of assessment employ three or more full-time employees (other than any employee who is a shareholder of the company or member of the close corporation, as the case may be, or who is a connected person in relation to a shareholder or member), who are on a full-time basis engaged in the business of that company or close corporation of rendering that service."

Archived

Provided all the other necessary requirements have been met a company, which is primarily engaged in the provision of any personal service will be able to qualify as an SBC, if-

- the company, throughout the year of assessment employs three or more full-time employees who are on a full-time basis engaged in the business of that company of rendering that service; and
- the investment income of such company does not exceed 20% of the company's total receipts and accruals.

Where the activity carried on by a company is one of the activities listed under the definition of 'personal service', but the company employs at least three or more full-time employees (excluding shareholders and connected persons to such shareholders) who throughout the year of assessment render the specific

service, the 20% limitation will only be applicable to any investment income received by or accrued to the company during the year of assessment. The 20% limitation is, therefore, not applied to income from services rendered if such services cannot be regarded as 'personal service'. The 20% limitation in respect of investment income will similarly be applicable where the activity carried on by the company is not one of the activities listed under the 'personal service' definition, irrespective of the number of persons employed by the company.

The Act does not prescribe any specific method of record keeping in calculating the 20% limitation in respect of 'personal service' income. The fact that the 'personal service' income does not exceed 20% of the company's total receipts and accruals must, however, be substantiated and this may be done either by means of a charge out system per hour/per job or any other method used by the taxpayer.

The 20% limitation in respect of the receipts and accruals attributable to investments and personal service income is calculated as follows:

Archived

Example 3

For its financial year ending 31 March 2007, a company, which renders consulting services to a large number of clients, has two members and two full-time employees. The two full-time employees have no interest in the company. The two employees are engaged in the business of the company, i.e. the rendering of consulting services. Consulting services is one of the listed activities under the definition of 'personal service'.

The requirement that the company should, throughout the year of assessment, employ at least three full-time employees (excluding shareholders/members or connected persons to such shareholders/members) so as not to fall within the definition of 'personal service' has not been met. The service rendered by the company is therefore regarded as 'personal service' and the 20% limitation in respect of receipts/accruals attributable to personal service and investment income must be applied.

The company received the following income for the year of assessment from 1 April 2006 to 31 March 2007:

Income from services rendered by (2) employees	R3 900 000
Income from services rendered by shareholders	R1 100 000
Royalties received	R 23 000
Benefit received under a will (capital receipt)	R 950 000
Capital gain on disposal of an SBC asset *	R 40 000
Total receipts/accruals	R6 013 000

* The capital gain is in respect of a depreciable asset. This gain cannot be deferred as the taxpayer indicated that it did not intend acquiring any replacement asset. An election to defer the gain in terms of paragraph 65 or 66 of the Eighth Schedule to the Act is therefore not available in this instance.

The total receipts/accruals for the purposes of calculating the 20% limitation is R5 063 000 (R6 013 000 – R950 000). (The capital receipt of R950 000 is excluded,

but the capital gain of R40 000 is included.)

The investment income (royalties) and income from the rendering of personal service expressed as a percentage of the total receipts and accruals (including the capital gain) is [(R23 000 + R1 100 000)/R5 063 000] x 100 = 22.18%

Investment income and income from the rendering of a personal service exceed the 20% limitation for the relevant year of assessment and the company will not qualify as an SBC, notwithstanding the fact that the ownership and gross income requirements may have been met.

Note: If the above company had employed three or more full-time employees (excluding the shareholders or connected persons to such shareholders) throughout the year of assessment to render the consulting services, the 20% limitation in respect of the income from rendering a personal service would not have been required, as the service would not be regarded as 'personal service'. The 20% limitation would, however, have to be applied to any investment income received/accrued during the year of assessment, as follows:

The following is assumed:

The company employed three full-time employees who also render consulting services. The following income was received for the financial year ending 31 March 2007.

Income from services rendered by employees (3)	R2 800 000
Income from services rendered by shareholders	R1 000 000
Royalties received	R1 113 000
Benefit received under a will (capital receipt)	R 950 000
Capital gain on disposal of an SBC asset	R 40 000
Total receipts/accruals	R5 903 000

The services rendered by the company do not fall within the definition of 'personal service' as the company employed three full-time employees (excluding the shareholders or connected persons to such shareholders) throughout the year of assessment to render the consulting services. Any income attributable to services rendered by the shareholders is therefore not subject to the 20% limitation. The 20% limitation must, however, be applied to any investment income received/accrued.

The total receipts/accruals for the purposes of calculating the 20% limitation in respect of the investment income is R4 953 000 (R5 903 000 – R950 000), excluding the capital receipt of R950 000, but including the capital gain of R40 000.

The investment income (royalties) expressed as a percentage of the total receipts/accruals (including the capital gain) is R1 113 000/R4 953 000 x 100 = 22.47%

The investment income exceeds the 20% limitation for the relevant year of assessment and the company will not qualify as an SBC, despite the fact that the services rendered do not constitute the rendering of a 'personal service' and the ownership and gross income requirements have been met.

Archived

f) The company may not be an employment company

The following companies are regarded as employment companies for the purposes of section 12E:

- A company which is a labour broker as defined in the Fourth Schedule to the Act, other than a labour broker in respect of which a certificate of exemption has been issued in terms of paragraph 2(5) of the Fourth Schedule.

- A personal service company as defined in paragraph 1 the Fourth Schedule.

Provided that all the other requirements have been met, a labour broker with an exemption certificate (IRP 30) will qualify as an SBC (See Interpretation Note 17 which is available on the SARS website). In the case of a personal service company, such company will qualify as an SBC if the company, throughout the year of assessment, employ three or more full-time employees who are engaged on a full-time basis in the business of the company, co-operative or close corporation of rendering the relevant service.

It is important to note that 'personal service' and 'personal service company' are both defined and therefore have different meanings. 'Personal service' as defined in section 12E concerns a specific category of activities that are performed by the shareholders of the company. A 'personal service company' is defined in Fourth Schedule and is a company (other than a company which is labour broker) where services are rendered on behalf of that company to a client of that company personally by any person who is a connected person in relation to that company, and –

- that person would be regarded as an employee of that client if that service was rendered by that person directly to the client; or
- that person or that company is subject to the control or supervision of that client as to the manner in which the duties are performed in rendering that service and must be mainly performed at the premises of the client; or
- more than 80% on the income of that company consists of amounts directly or indirectly received from one client.

A company that falls within the above definition of a personal service company will, therefore, not qualify as an SBC. Should a company, however, employ three or more full-time employees (excluding shareholders or any persons connected to such shareholders) throughout the year of assessment and such employees are engaged in the business of the company in rendering the specific service, the company may qualify as an SBC.

Archived

4. SBC assets

Section 12E(1), (1A) and (2) provides as follows:

"(1) Where any plant or machinery (hereinafter referred to as an asset) owned by a taxpayer which qualifies as a small business corporation or acquired by such a taxpayer as purchaser in terms of an agreement contemplated in paragraph *(a)* of an 'instalment credit agreement' as defined in section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991),—

(a) is brought into use for the first time by that taxpayer on or after 1 April 2001 for the purpose of that taxpayer's trade (other than mining or farming); and

(b) is used by that taxpayer directly in a process of manufacture (or any other process which in the opinion of the Commissioner is of a similar nature) carried on by that taxpayer,

a deduction equal to the cost of such asset shall be allowed in the year that such asset is so brought into use.

(1A) Where any machinery, plant, implement, utensil, article, aircraft or ship (hereinafter referred to as 'the asset'), other than an asset in respect of which subsection (1) applies, is acquired by a small business corporation under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005 and that asset would, but for the provisions of this section, have qualified for a deduction under section 11*(e)*, 12B or 12C, the deduction allowable must, subject to the requirements of that section, be equal to—

(a) 50 per cent of the cost of that asset, which is allowable in the year of assessment during which that asset is or was so brought into use for the first time;

(b) 30 per cent of that cost in the immediately succeeding year of assessment; and

(c) 20 per cent of that cost in the year of assessment immediately succeeding the year of assessment contemplated in subparagraph *(b)*."

(2) For the purposes of this section the cost to a taxpayer of any asset shall be deemed to be the lesser of the actual cost to the taxpayer to acquire that asset or the cost which a person would, if he had acquired the said asset under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the said asset was in fact concluded, have incurred in respect of the direct cost of acquisition of the asset, including the direct cost of the installation or erection thereof or, where the asset has been acquired to replace an asset which has been damaged or destroyed, such cost less any amount which has been recovered or recouped in respect of the damaged or destroyed asset and has been excluded from the taxpayer's income in terms of section 8(4)(*e*), whether in the current or any previous year of assessment."

Archived

4.1 Assets used directly in a process of manufacture

In terms of section 12E(1) an SBC that carries on a process of manufacture or a process which in the opinion of the Commissioner is of a similar nature may write off the full cost of an asset during the year of assessment in which such asset is brought into use for the first time. The deduction is subject to the following requirements:

- The asset must be brought into use for the first time by the SBC on or after 1 April 2001.
- The asset must be used directly in a process of manufacture or a process regarded by the Commissioner as being of a similar nature.

- A cost should have been incurred in acquiring the asset (an asset acquired for no consideration will, as a result, not qualify).

- The asset must be owned by the SBC or the SBC should have acquired the asset as purchaser in terms of an "instalment credit agreement" as defined in section 1 of the Value-Added Tax Act, 1991.

The asset does not need to be a new asset. An asset which qualifies for an allowance in terms of section 12E(1) will not qualify for any other allowance available in terms of the Act. As the full cost of an asset used in a process (or similar process) of manufacture is written-off in full in the year in which the asset is brought into use for the first time, such asset will not qualify for a scrapping allowance in terms of section 11(o) of the Act. On disposal thereof the asset will be subject to the recoupment provisions in terms of section 8(4)(a) of the Act.

4.2 Other SBC assets

Assets, other than assets used in a process of manufacture or a similar process, qualify for depreciation deductions in terms of sections 11(e), 12B or 12C of the Act. Where the aforementioned assets are acquired by an SBC under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005, the depreciation deduction in respect of assets which would have qualified for deductions in terms of sections 11(e), 12B or 12C will, for the purposes of section 12E(1A), be at a 50:30:20 rate over a three-year period (see **Example 6**). This means that an asset which was, for example, written-off on a *pro rata* basis over a 5 year period in terms of section 11(e) of the Act will now be written-off over a three-year period on the straight-line method in terms of section 12E(1A). The deduction in terms of section 12E(1A) is based on the cost of acquisition of an asset and an asset which was acquired for no consideration will, as a result, not qualify for any deduction under section 12E(1A) (see the **Note** under paragraph **4.3** below).

4.3 The cost of an asset

In terms of section 12E(2) the "cost" of an asset is for the purposes of both sections 12E(1) (assets used in a manufacturing or similar process) and 12E(1A) (other SBC assets) deemed to be the lesser of -

- the actual cost to the taxpayer;
- the direct acquisition cost that a person would have incurred if the asset had been acquired under an arm's length cash transaction on the date on which the transaction was in fact concluded; or
- the actual cost less the deferred recoupment in terms of section 8(4)(e) of the Act.

Archived

The above cost excludes interest and finance charges, but includes the direct cost of installation or erection of the asset.

Note: In view of the fact that the deductions in respect of SBC assets are based on the cost of an asset, no deductions will be available under either section 12E(1) or section 12E(1A) where the taxpayer acquired an asset for no consideration. Where an asset is acquired for no consideration, for example, by means of a donation, inheritance or as a dividend *in specie*, a wear and tear allowance based on the value of the asset will be allowed in terms of section 11(e).

4.4 Cost in moving an asset

Section 12E(3) provides as follows:

> ''(3) Any expenditure (other than expenditure referred to in section 11(a)) incurred by a taxpayer during any year of assessment in moving an asset in respect of which a deduction was allowed or is allowable under this section from one location to another must—
>
> (a) where the taxpayer is or was entitled to a deduction in respect of that asset under subsection (1A) in that year and one or more succeeding years, be allowed to be deducted from his or her income in equal instalments in that year and each succeeding year in which that deduction is allowable; or
>
> (b) in any other case, be allowed to be deducted from that taxpayer's income in that year.''

In terms of section 12E(3)(b), the cost of moving an asset which has been written off in full, must be allowed in the year in which the expenditure is incurred. This will also include an asset which was written off in terms of section 12E(1), i.e. an asset used in a process (or similar process) of manufacture.

Archived

Example 4

Company X is an SBC and its financial year-end is the last day of February. Due to unforeseen circumstances, company X had to move its business operations on a few occasions. The following information was submitted:

- Asset A qualifies for an allowance under section 12E(1A) and was acquired on 1 May 2005 at a cost of R100 000. The cost to move asset A is R6 000.
- Asset B qualifies for an allowance under section 12E(1) and was acquired on 1 April 2005 at a cost of R50 000. The cost to move asset B is R4 000.

Calculate the section 12E allowances for asset A and B for the 2006 to 2008 years of assessment as well as the moving costs that will be allowed for the 2006, 2007 and 2009 years of assessment based on the following assumptions:

- The assets are moved on 1 July 2005
- The assets are moved on 1 July 2006
- The assets are moved on 1 July 2008

a) **Calculation of section 12E(1A) deductions for asset A**

2006 year of assessment: 50% of R100 000 = R50 000
2007 year of assessment: 30% of R100 000 = R30 000
2008 year of assessment: 20% of R100 000 = R20 000

b) **Calculation of deduction of moving costs of asset A based on date of move**

- 1 July 2005 (2006 year of assessment) [in terms of section 12E (3)(a)]
  2006 year of assessment: R2 000
  2007 year of assessment: R2 000
  2008 year of assessment: R2 000

- 1 July 2006 (2007 year of assessment) [in terms of section 12E (3)(a)]
  2007 year of assessment: R3 000
  2008 year of assessment: R3 000

- 1 July 2008 (2009 year of assessment) [in terms of section 12E (3)(b)]
  2009 year of assessment: R6 000

c) **Calculation of section 12E (1) deductions for asset B**

2006 year of assessment: R50 000 (once off)

d) **Calculation of deduction of moving costs of asset B (irrespective whether incurred during the 2006, 2007 or 2009 year of assessment)**

Deduction: R4 000 (once off) [in terms of section 12E (3)(b)]

Archived

4.4.1 Assets acquired for no consideration

Where an asset is acquired for no consideration, for example, by means of a donation, inheritance or as a dividend *in specie*, the value of the asset must be increased by any cost incurred in respect of the installation, erection or moving of the asset in terms of section 11(e)(v). Expenditure incurred in respect of the installation, erection or moving of the asset must therefore be written off in terms of section 11(e).

4.4.2 Assets written off in full in terms of section 11(e)

Where an asset which has been written off in full in terms of section 11(e) is moved from one location to another, the installation, erection or moving costs will be allowed as a deduction in the year of assessment in which such costs were incurred.

4.5 Recoupment

Any amount which is recovered or recouped as a result of the disposal of an asset used by an SBC is subject to the recoupment provisions in terms of section 8(4)(a) of the Act. The inclusion of the amount which is recovered or recouped can, however, notwithstanding the provisions of section 8(4)(a) be deferred in terms of section 8(4)(e) if the taxpayer has made an election that paragraph 65 or 66 of the Eighth Schedule should apply. The election to defer the recoupment of allowances previously granted can be made only if the proceeds in respect of the disposal of the asset are equal to or

exceed the base cost of the asset and the taxpayer intends acquiring a replacement asset. The amount to be recovered/recouped as well as any capital gain (if any) is spread over the future years of assessment in proportion to the capital allowances to be claimed on the replacement asset. This method of deferring recouped allowances and capital gains is available in respect of assets which are disposed of on or after 22 December 2003.

Example 5

An SBC with a February financial year-end, acquired a machine costing R400 000 on 1 May 2005 and immediately brought the machine into use for the purposes of conducting its farming operations. The machine is however damaged beyond repair in a fire on 2 December 2006 and an amount of R400 000 is paid out on 31 March 2007 in terms of a contract of insurance. The taxpayer has elected that paragraph 66 of the Eighth Schedule must apply and any recoupment is therefore deferred in terms of section 8(4)(e).

The taxpayer has indicated that -

- a replacement machine will be acquired within a period of one year subsequent to the disposal of the original machine; and
- the replacement machine will be brought into use within a period of three years from the date of disposal of the original machine.

Calculate the allowances and/or recoupment for the 2006 to 2010 years of assessment if the taxpayer concluded an agreement for the acquisition of the replacement asset on 1 April 2007. The cost of the replacement asset is R450 000.

Note: The machine would, but for the provisions of section 12E, have qualified for a section 12B(f) allowance. The accelerated depreciation in terms of section 12E(1A) is therefore applicable.

2006

Section 12E(1A) allowance	R400 000 x 50% =	R200 000

2007

Section 12E(1A) allowance	R400 000 x 30% =	R120 000

2008

Original cost	R400 000
Less: Allowances claimed in 2006 and 2007	R320 000
Tax value as at 1 March 2007	R 80 000
Insurance proceeds	R400 000
Recoupment	R320 000

The time of disposal in terms of paragraph 13 of the Eighth Schedule is 31 March 2007, i.e. the date on which the compensation in respect of the damaged asset is received.

Capital allowances for the replacement asset:

2008	R450 000 x 50% =	R225 000
2009	R450 000 x 30% =	R135 000
2010	R450 000 x 20% =	R 90 000
		R450 000

Archived

Recoupment included in income:
2008 R320 000 x 50% = R 160 000
2009 R320 000 x 30% = R 96 000
2010 R320 000 x 20% = R 64 000
R320 000

5. Tax rates

The tax rate applicable to SBCs in respect of years of assessment ending during the period 1 April 2006 and 31 March 2007 is as follows:

Years of assessment ending between 1 April 2006 31 March 2007		
Normal Tax	From Taxable Income	To Taxable Income
0%	R0	R40 000
10%	R40 000	R300 000
29%	R300 000	and above

6. Objection and appeal

Any decision made by the Commissioner under the provisions of section 12E is subject to objection and appeal.

7. Conclusion

An SBC which has complied with all the requirements of an SBC in one year does not necessarily indicate compliance in respect of any subsequent year of assessment. The facts of each case will, therefore, have to be considered for every year of assessment in order to determine whether the SBC complies with all the requirements for the specific year under review.

Archived

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Date of first issue: 13 December 2002
Date of second issue: 29 March 2004
Date of third issue: 13 January 2006